

A-Section

SEC to study rules on private trading

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At a time when investors are clamoring for shares in companies such as [Facebook](#), [Twitter](#) and [LinkedIn](#), which aren't listed on any public stock exchange and aren't required to comply with a variety of rules meant to protect investors, officials are considering whether to make it harder or easier to sell stock in a shadow market.

Securities and Exchange Commission Chairman **Mary Schapiro** said this week that she has asked the agency to study the issue, at least with respect to small businesses.

"[At] my request the staff is taking a fresh look at our rules to develop ideas for the Commission about ways to reduce the regulatory burdens on small business capital formation in a manner consistent with investor protection," Schapiro wrote.

Schapiro was responding to a top congressional overseer, who is pushing the agency to ease restrictions.

Rep. Darrell Issa (R-Calif.), chairman of the House Committee on Oversight and Government Reform, sent Schapiro a letter last month arguing that the SEC "discourages private capital formation."

The SEC "should take all possible steps to arrest the decline of capital formation," Issa wrote, adding that one long-standing rule poses a "fundamental roadblock."

Generally, companies that want to sell stock to the public must make elaborate disclosures, including audited statements of their profits and losses, details about executive pay and explanations of "risk factors" that could jeopardize the company's success.

But some companies want to be able to raise money from investors without going to those lengths. They prefer to keep their finances confidential, or to focus on longer-term considerations than how the stock market will react to their next quarterly earnings report. They chafe under a rule that requires them to meet SEC requirements when they amass more than 499 shareholders.

For their part, many investors are eager to get a piece of hot companies before they go public, just like investors during the dotcom era scrambled for "friends and family" shares that would give them a chance to reap windfalls when companies later went ahead with initial public offerings.

[Facebook](#), the social-networking site, brought the issue into focus months ago, when it enlisted [Goldman Sachs](#) to help it sell stock through a private offering. [Facebook](#) and Goldman limited the offering to foreign investors, a choice that Issa said reflected poorly on the United States. ([Washington Post Co.](#) Chairman Donald E. Graham sits on [Facebook's](#) board of directors.)

Meanwhile, shadow trading platforms have emerged for shares of pre-IPO companies, including shares sold by employees.

Those developments have crystallized competing concerns. Are the rules too easy to get around? Or are they undermining the competitiveness of U.S. financial markets and driving business overseas?

The outcome of the SEC's review could affect not just the interests of investors but also the balance of power in the financial industry, where investment bankers' traditionally lucrative central role in stock offerings faces new challenges.

An expansion of the shadow market for stocks could also diminish the SEC's influence by putting more trading beyond its reach.

In her March 22 letter addressing a list of questions raised by Issa, Schapiro cited arguments on all sides of the debate, and she did not commit to any particular result.

For example, she noted that some observers oppose a ban on general investment solicitations by private companies as unnecessary and "a significant impediment to capital raising."

But she added that others support the restriction "on the grounds that it helps prevent securities fraud."

The letter was reported by the Wall Street Journal.

The 500-shareholder threshold that triggers disclosure requirements is one of the issues that should be examined, Schapiro said.

But so is the way those shareholders are counted, she added. Although a brokerage firm buys shares in a public company for thousands of clients, the broker is the holder of record and counts as only one shareholder.

As a result, Schapiro said, many public companies with more than 500 actual shareholders have fewer than 500 shareholders of

record and can stop complying with the disclosure requirements.

Schapiro cited reasons to doubt that regulation is costing the U.S. market its edge.

"Compliance costs alone do not seem to explain the choice by the average global initial public offering company not to list in the United States," she said.

Schapiro also cited one reason companies might choose to sell stock on European exchanges: firms that underwrite IPOs in Europe "charge significantly lower fees."

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